



*Michael C. Schlachter, CFA
Managing Director and Principal*

September 26, 2008

Ms. Anne Stausboll
Interim Chief Investment Officer
California Public Employees' Retirement System
400 Q Street
Sacramento, CA 95814

Re: Proposed Synthetic Enhanced Equity Portfolio Policies

Dear Anne,

You requested Wilshire's opinion with respect to Staff's proposal to change three policies to allow for the creation of a US equity enhanced index strategy, using fixed income securities as the alpha engine and derivatives to provide equity market exposure. Wilshire supports this endeavor.

Recommendation

Wilshire has reviewed all three proposed policy changes and recommends that the Investment Policy Sub-Committee approve the changes as proposed.

Discussion

As far back as the fall of 2007, Wilshire has recommended that Staff develop an internally managed synthetic enhanced portfolio of the type Staff is currently developing. Since that proposal, we have worked closely with Staff to structure of such a portfolio and the timing of when it should be launched. Given the wide "credit spreads" in the marketplace at the present time, we believe that a portfolio managed to avoid defaults but to capitalize on many of the current dislocations in the credit markets can have potentially great success.

After reviewing the first version of the proposed policy, we recommended that Staff add language to the equity policy that better clarifies the expected life of this portfolio and which adds more explicit controls over the type of internally-managed fixed income pool that will be used. In addition, we recommended that Staff add language to the equity policy that cross-references the fixed income policy regarding duration, credit risk, and diversification in order to explicitly state the risk controls that will be in place for the value-added portion of this portfolio.

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We note that Staff has made the changes we recommended in the most recent version of this policy. As a result, we recommend that the policy be approved.

If you have any questions or comments, please let me know.

Sincerely,

A handwritten signature in black ink, appearing to be "Michael" followed by a stylized surname.